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VIA E-MAIL SUBMISSON

March 13, 2020

Ms. Vanessa A. Countryman
Secretary, Securities and Exchange Commission
100 F. Street N.E.
Washington D.C. 20549-1090

Re: Amending the "Accredited Investor" Definition; File No. S7-25-19

Dear Ms. Countryman:

The author[1] applauds the work of the Security and Exchange Commission ("SEC" or "Commission") in preparing this proposal and greatly appreciates the opportunity to comment on the Commission's proposed amendments to Rule 501(a) of Regulation D under the Securities Act of 1933.[2] The author generally supports the Commission's recent efforts to review and improve the "accredited investor" definition as detailed in the Proposal. Some suggestions with regard to adequate investor protection shall be discussed below.

This Comment Letter only discusses the proposed amendments to the accredited investor definition as it relates to natural persons. The Letter focuses on four broad topics highlighted in the Commission's Proposal: (1) the need to update the current accredited investor definition; (2) the need to adjust the monetary threshold in the accredited investor definition; (3) the addition of categories of individuals who do not meet the financial threshold but satisfy the sophistication requirement through other means; and (4) suggested amendments to the Proposal. While the author recognizes that all questions and concerns listed in the Proposal are of high relevance, this Letter does not attempt to answer every question posed by the Commission. This Comment Letter solely expresses the author's personal views on the Commission's proposed amendments to the accredited investor definition and not the views of any university or employer.

[1] The author is a third-year law student at Hofstra University School of Law and a Senior Associate Editor of the Hofstra Law Review. During her studies at Hofstra Law School the author excelled in various Business Law courses and is currently enrolled in a Securities Regulation Course. She obtained a Bachelors of Law in European and Comparative Law in Germany where she focused her studies on German and European Business Law. Over the course of her career the author has interned with an international accounting firm in Germany, in the Capital Markets practice group of a major NYC law firm, as well as in the legal department of public companies in the United States and Germany.

[2] The SEC's Proposal ("Amending the 'Accredited Investor' Definition," 85 FR 2574 (Jan. 15, 2020)) ("the Proposal") proposes amendments to the definition of "accredited investor" to add more categories of qualifying natural persons and certain other modifications to the current definition. The goal of the amendments is to update and improve the definition in order to expand the pool of sophisticated investors to more individuals and entities that demonstrate the requisite knowledge and expertise to participate in certain investments without the disclosure requirements and additional protections of the Securities Act of 1933.

I. PRELIMINARY OBSERVATIONS

The purpose of the registration and disclosure requirement of Section 5 of the Securities Act of 1933 ("the Securities Act" or "1933 Act") is to protect potential investors by requiring full disclosure of all material information about issuers necessary to make informed investment decisions. Section 4(a)(2) of the Securities Act provides for certain exemptions from the registration and disclosure requirements for transactions "not involving any public offering." Congress did, however, not specify how the exemptions should be applied. The Supreme Court first discussed the standard for these exemptions in *SEC v. Ralston Purina*[3]. The Court held that the question of whether an offering should be exempt from the dual obligations of Section 5 of the Securities Act must be determined in light of the statutory purpose. Thus, the key factor in assessing the availability of an exemption is whether the "class of persons affected needs the protection of the Act."[4] An offering to individuals who are able to "fend for themselves" and have access to material information is, thus, not considered a public offering.

Rule 506 of Regulation D is considered a "safe harbor" under Section 4(a)(2). Under this rule issuers can sell unregistered securities to an unlimited amount of "accredited investors". The purpose of Regulation D is to promote capital formation by exempting certain securities from the registration requirements, while simultaneously maintaining adequate investor protections. The accredited investor definition is the single most important criteria in determining who may invest in certain exempt offerings under Rule 506(b) and 506(c).

The current accredited investor definition under Rule 501 measures an individual's "financial sophistication" by his or her net worth of at least $1 million, exclusive of the individual's primary residence, or an annual income of at least $200,000 (or $300,000 for joint income with a spouse) for the last two years. The basis for this definition is that wealthy investors that meet the threshold are presumed to be able to bear the risk of economic loss and, thus, do not need the protections afforded by the registration requirement of the Securities Act.

Despite its tremendous significance, some of the definitions key provisions have not changed since their adoption in 1982 (aside from the exclusion of the investor's primary residence from the $1 million net worth standard in 2010). The author commends the Commission for taking on this timely issue. In amending the current definition, the Commission should focus on how to achieve the goal of identifying a class of individuals who do not need the protections of the 1933 Act. Preserving the current pool of accredited investors should not be the primary factor in determining which changes to implement. While the author recognizes the importance of preserving an adequate amount of accredited investors to ensure continued capital formation, the primary goal of the amended definition should be to guarantee an appropriate definition based on an investor's demonstrated sophistication or the investor's ability to sustain the risk of loss associated with investing in the private market.

[3] 346 U.S. 119 (1953).
[4] *Id.* at 125.

II. SPECIFIC AREAS OF CONCERN

A. The Commission Should Revise the Current Financial Threshold in the Accredited Investor Definition to Account for Inflation

The Commission states the belief that an adjustment of the financial threshold in the accredited investor definition is not warranted and feasible at this time but, nonetheless, invites comments on the issue. The author urges the Commission to reconsider its decision as an adjustment is not only definitively warranted but essential for the protection of investors.

While net worth and annual income standards are limited considerations for financial sophistication, the author recognizes the benefits of the bright-line rule approach. Nevertheless, the current financial threshold fails to account for decades of inflation. The financial threshold has not been comprehensively re-examined since its adoption in 1982 (except for the exclusion of the investor's primary residence from the $1 million net worth standard with the enactment of the Dodd-Frank Act in 2010). According to the Proposal, the $200,000 income standard, if adjusted for inflation since 1982 to 2019, would amount to an annual income of $538,000 and the $1 million net worth requirement would equal $2.7 million if adjusted for inflation. By the statistics set forth in the Proposal the overall percentage of qualifying households increased from 1.6% in 1983 (one year after the adoption of Regulation D) to 13% in 2019.[5]

Although the current thresholds may still exceed the mean and median household income and net worth in all regions of the country, the goal of protecting vulnerable investors and making private offerings available only to investors who can bear the economic loss, can no longer be achieved with the current threshold. The low percentage of qualifying households at the time of adoption of Regulation D demonstrates that only the wealthiest individuals were presumed to be able to sustain the high risk of loss. With this percentage rising well over 10% since its inception the Commission cannot contend that the same goal is achieved. The exclusion of the value of the primary residence from an individual's net worth in 2010 is clearly not sufficient to counter inflation as the number of qualifying households rose to 13% in 2019.

A frequently cited argument against raising the financial threshold is the potential disruptive effect the adjustment could have on the Regulation D market which plays a vital role in U.S. capital formation. The Proposal suggests that an inflation-adjusted threshold would reduce the number of qualifying households from 13% to 4.2%. This concern is misguided for several reasons. Firstly, there is no data supporting that the lower net worth qualifying households actually participate in the private market and, thus, the effect of these individuals not qualifying as accredited investors after the adjustment is questionable. Secondly, given the planned simultaneous expansion of the accredited investor definition based on additional categories of qualifying individuals, it is unclear how much of a disruption to the private market the adjustment of the financial threshold will really be. Thirdly, the Commission's 2015 Report on the Review of the Definition of "Accredited Investor" ("2015 Report") establishes that U.S. household income has increased about 2.65% in the last 20 years while the average annual inflation over the same period is only 2.37%.[6] Thus, adjusting financial thresholds will not

[5] SEC, "Amending the 'Accredited Investor' Definition," 85 FR 2574, 75-77 (Jan. 15, 2020).
[6] SEC, Report on the Review of the Definition of "Accredited Investor" 115-16 (2015).

increase the amount of qualifying accredited investors in the long term after the first initial adjustment. And lastly, even if the adjustment should have an effect on capital formation in the private market, the affected companies can shift their capital formation to the public market aiding the Commission's efforts in boosting IPOs. The Commission aims to make private offerings accessible to more individuals because of the enormous growth the market experienced over the last decades. But the growth of the private market, as the Commission is undoubtedly aware, is inevitably linked to the decline of the public market. Where investors could once invest in relatively small public companies with the chance to multiply their investments significantly, companies now decide to remain private until they reached a much higher market capitalization, leaving the large shares of capital gains (that would have went to average households in the public markets) to wealthy investors. Thus, the average American has a great interest in a healthy public market that fosters IPOs at an earlier stage. The numerous exemptions to the registration requirement advanced the shift from SEC oversight in the public market to the more risky, unregistered offerings in private markets. A decline in qualifying households in private offerings could be a first step towards a more vibrant public market accessible to the average American.

Another argument against adjusting the financial threshold is the disparity in income and cost of living between different regions of the United States. Households that qualify as accredited investors are more likely to be located in the Northeastern and Western regions of the country. Purportedly, the adjustment of the threshold would lead to even greater disparities. However, this disparity will be balanced by the additional categories added to the accredited investor definition such as individuals with professional certifications or designations, knowledgeable employees of a private fund (both discussed below) as well as the expansion of qualifying entities such as family offices and their family clients, registered investment advisors, LLCs with more than $5 million in assets, and rural business investment companies.

The Commission also considers other changes over the years that purportedly justify the increased number of qualifying households. One factor is the broad availability of information due to the evolution of the internet, as well as other advances in technologies. The Proposal specifically mentions the rise of social media and other forms of communication that makes information about issuers and unregistered securities more readily available to a wide range of market participant. However, the new forms of communication also present a new risk. Where scrupulous promoters used to market potential investments through the mail or newspaper advertisements, investors had time to deliberate the investment. The rise of the internet and electronic communications, however, enables investors to instantaneously react on potential investments, not allowing time to "cool off." Furthermore, the enhanced availability of information should not be equated to greater knowledge. The numerous unreliable and misleading information available to investors may make it even harder to adequately analyze an investments merits and risks. Lastly, the availability of information should not be considered in determining the financial threshold where the justification for the threshold is based on the investors ability to bear the loss rather than his or her knowledge about the securities or the issuer.

The Proposal further suggests that the Commission is not aware of any wide spread abuse regarding Regulation D offerings that would show that an adjustment of the financial threshold is warranted. However, such abuse does in fact exist. The SEC has charged at least four companies with defrauding investors through Ponzi-like schemes in connection with unregistered securities in the first two months of 2020.[7] Furthermore, reports from the North American Securities Administration Association ("NASAA") show that exempt offerings are frequently associated with fraud, being listed within the top five "most reported products & schemes."[8]

Senior investors are at an especially high risk of being deceived by fraudulent offerings and, simultaneously, account for a great number of accredited investors, purportedly not needing the protections of the Securities Act. Recent data published by Fidelity shows that the number of millionaire retirees continues to significantly increase. The amount of people with $1 million or more in their 401(k) increased by 45 percent in a year.[9] Every one of these individuals qualifies as accredited investor under the current definition based solely on their retirement savings. The Commission's 2015 Report estimates that 20.3% of accredited investors in 2015 were retirees.[10] Retirees have little to no time to recover from a substantial loss. Simultaneously, senior investors remain the main target of securities fraud. Unregistered securities are among the most pervasive products used to facilitate senior investment fraud.[11] A recent, extremely impactful, example is the alleged Ponzi scheme by the Woodbridge Group of Companies. Woodbridge limited its offerings to accredited investors, many of which lost their retirement savings in the scheme.[12] As mentioned above, comparable schemes are not uncommon albeit on a smaller scale. There is sufficient precedent of Regulation D abuse to warrant an adjustment of the financial threshold in the accredited investor definition.

Based on the foregoing, the Commission should adjust its approach to the accredited investor definition not to further expand the scope of unregistered securities offerings per se but rather to align the exemption with the realities of our time. The reasoning for not revising the financial threshold is flawed and the Commission must not disregard its mission of investor protection over its pursuit for capital formation.

B. The Commission Should Add an Additional Category for Individual's to Qualify as Accredited Investors Based on Qualifications Other Than Income and Net Worth

Traditionally, exemptions of certain securities or transactions from the registration requirements of the 1933 Act can be said to have been linked to three broad categories: (1) the securities are considered reliable because they are offered by the municipal, state, or federal governments; (2) the offering is restricted to one state or a limited number of investors; or (3) the

7 *Press Releases*, SEC, https://www.sec.gov/news/pressreleases (last visited Mar. 8, 2020).
8 *See e.g. NASAA Enf't Report: 2015 Report on 2014 Data*, NASAA 7 (2015), http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/08/2015-Enforcement-Report-on-2014-Data_FINAL.pdf; *NASAA Enf't Report: 2014 Report on 2013 Data*, NASAA 7 (2014), https://www.nasaa.org/wp-content/uploads/2011/08/2014-Enforcement-Report-on-2013-Data_110414.pdf.
9 *Fidelity Announces Q1 2018 Retirement Data: Saving Rates Hit Record High and Account Balances Continue to Increase Over Long-Term*, FIDELITY (2018), https://www.fidelity.com/about-fidelity/employer-services/fidelity-announces-q1-2018-retirement-data.
10 SEC, Report on the Review of the Definition of "Accredited Investor" 51 (2015).
11 *See e.g. NASAA 2019 Enf't Report*, NASAA 8 (2019), https://www.nd.gov/securities/sites/default/files/news/2019-Enforcement-Report-Based-on-2018-Data-Final.pdf.
12 *See* Complaint at ¶¶ 3, 63, SEC v. Shapiro, et al, No. 1:17-cv-24624-MGC (S.D. Fla. Dec. 20, 2017); *see also Press Release, Court Orders $1 Billion Judgement Against Operators of Woodbridge Ponzi Scheme Targeting Retail Investors*, SEC (Jan. 28, 2019), https://www.sec.gov/news/press-release/2019-3.

securities are offered to a class of accredited investors who do not need the protection of the Securities Act. In the past years, a new rationale developed with Regulation Crowdfunding, setting an investment limit for individuals and, thus, limiting the loss an individual investor can incur.

Accredited investor is defined in Section 2(a)(15)(ii) of the 1933 Act as “any person who, on the basis of such factors as financial sophistication, net worth, knowledge, and experience in financial matters, or amount of assets under management qualifies as an accredited investor under rules and regulations which the Commission shall prescribe.” Considering the language of the statute together with the Supreme Court’s analysis of Section 4(a)(2) in *Ralston Purina*, three main factors are determinative of an individual’s financial sophistication: (1) an individual’s ability to gain access to material information of the kind usually included in a company’s registration statement; (2) an individual’s knowledge and experience in financial matters relevant to his ability to evaluate merits and risks without the full disclosure provided in public offerings; and (3) an individual’s ability to bear the risk of loss associated with private offerings.

The subsequently enacted regulations by the Commission solely focus on an individual’s ability to bear the risk of loss. Rule 215(e), (f) and Rule 501(a)(5), (6) define an accredited investor as “any natural person whose individual net worth, or joint net worth with that person's spouse, exceeds $1,000,000” and “any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.”

While the rule making was well intended, it ignored other crucial factors set out in the statute for determining whether an individual investor possesses the requisite financial sophistication such as industry knowledge and experience. Wealth is a very poor indicator of sophistication, especially considering the inadequacy of the threshold in light of inflation as discussed above. While the author recognizes that reliance on financial thresholds can lead to a clear and easy-to-apply rule, the approach over-simplifies the factors that determine whether an individual requires the protections of the Securities Act. Unfortunately, given the 38 years of practice in using this definition, it seems unlikely that the financial threshold would be abrogated as sole indicator of sophistication. However, at the very least, a new category to the accredited investor definition that allows certain knowledgeable individuals, who have the ability to analyze the merits and risks of a given investment, to participate in the Regulation D market even if they do not meet the financial threshold is a long overdue addition to the definition.

Certain professional certifications and designations can indicate an individual’s actual financial sophistication that renders him or her less in need of the protections of the Securities Act. Individuals licensed to advise others in connection with private placements should most certainly be added to the new category of accredited investors. These individuals have demonstrated extensive knowledge in securities and investing, such as to be permitted to represent or advise others in connection with securities market transactions and should, thus, be permitted to invest in private offerings for themselves. In determining qualifying credentials, the Commission should consider whether the certification or degree tests knowledge relevant to the evaluation of securities offerings.

The Commission should consider adding certain certifications administered by private organizations to the credentials satisfying the accredited investor definition. The concern that the private organizations issuing these credentials are not subject to Commission oversight can be overcome in a cost-effective manner by relying on an outside, independent certifying organization such as the National Commission for Certifying Agencies or the American National Standards Institute ("ANSI"). Private organizations could be required to undergo independent accreditation to show that their certification programs meet recognized standards. Agencies such as the Department of Defense, Department of Energy, and Food and Drug Administration already rely on ANSI accreditation to determine whether a private certification is credible.

The criteria set out by the Commission for determining whether a professional certification or designation qualifies for accredited investor status are suitable to allow for some flexibility should new certifications, designations, or credentials develop over time. However, the criteria that the professional certification or credential be publicly available should not be a requirement as long as the individual can demonstrate that he or she has in fact obtained such certification, designation, or credential. Furthermore, the Commission should add that certain private institutions may also administer selected examinations provided they undergo independent accreditation.

The Commission has also suggested to add certain "knowledgeable employees" of a private fund "who, in connection with his or her regular functions or duties, participates in the investment activities of such [fund]" to the amended definition. Any such individual likely has sufficient experience and access to information necessary to make an informed investment decision relating to his or her employer's fund and, therefore, does not need the protections of the Securities Act. Knowledgeable employees of a private fund should be added to the amended definition.

Lastly, credentials from accredited education institutions should not be added to the definition as they are a poor indicator for financial sophistication. While almost all MBA programs require at least a course in accounting, the degree does not necessarily enable an individual to assess the merits and risks of a securities offering without the protections of a registration statement. The same holds true for a Juris Doctor or any given Bachelor's degree. While graduates may have taken courses in Investment Management or Securities, they do not necessarily possess the required financial sophistication absent any more specialized work in the field. The certifications or credentials should show a significant level of financial sophistication in order to balance the decreased ability to sustain financial losses. The Commission should, therefore, not include credentials from accredited institutions in the initial order.

C. The Commission Should Permit Spousal Equivalents to Pool their Finances for the Purpose of Qualifying as Accredited Investors.

The author applauds the Commission for considering this amendment to the current accredited investor definition, as it is a step towards reconciling the securities laws with societies values. Spousal equivalents should be treated equal to spouses for the purpose of calculating the financial thresholds of the accredited investor definition.

III. RECOMMENDATIONS

As Part II A. of this Letter illustrates, an adjustment to the financial threshold is absolutely crucial to ensure adequate investor protection. The concerns set forth by the Commission and several Commenters regarding the adjustment and its disrupting effects on the Regulation D market are misguided as set out above. The Commission must consider the underlying rationales justifying the exemption, in particular the individual investors' ability to "fend for themselves" and their access to material information, in determining the scope of the amendment. While the rationale for the financial threshold is the individual investor's ability to sustain the loss of a risky investment, the current numbers do not accomplish that. An adjustment for inflation as of 2019 would put the new threshold at $538,000 for the annual income requirement and $2.7 million for the net worth requirement. In order to offset the Commission's concern that an adjustment would unduly disrupt the Regulation D market, a conceivable solution would be twofold: (1) the adjustment of net worth may be considered in light of the changes implemented by the Dodd Frank Act, which excluded the investor's primary residence from the calculation; and (2) current accredited investors could be grandfathered into that status with regards to offerings by the same issuer in order to prevent diluting the initial holder's position by barring them from participating in subsequent offerings of the same issuer.

Furthermore, the financial threshold must be indexed for inflation on a going forward basis. Indexing for inflation will be a sensible solution to the same problem arising in the future. As discussed above, this approach would not decrease the accredited investor pool over time because the U.S. household income has increased by a higher percentage (approx. 2.65%) in the last 20 years than the average annual inflation over the same period (approx. 2.37%). Thus, an inflation index would have no disrupting effect on the Regulation D market but quite to the contrary will avoid a grave market disruption in the future. Setting fixed amounts for future inflation is, however, not recommended instead the regulation should cite to an organization such as the United States Federal Reserve to determine the inflation rate at any given time in the future. The inflation index must be added to the amended definition even if the Commission should decide not to adjust the current financial threshold for inflation.

Another conceivable amendment would be to require a questionnaire similar to the FINRA New Account Form ("NAF") in addition to the financial threshold in order to determine an individual's ability to take losses. Questions on the NAF include topics such as—in addition to the individual's annual income and net worth—a potential investor's liquid net worth, annual expenses, special expenses, liquidity needs, risk tolerance, financial investing experience, and how the account will be funded.[13] Some weight must be given to the source of funding. If an investor attempts to fund an investment entirely with retirement accounts, it must be considered whether the individual has sufficient time to make up for a potential loss. Another alternative would be to exclude retirement accounts for the net worth calculation. Using a questionnaire similar to the NAF would give a more accurate estimate of how much financial risk the potential investor can really bear. The approach would further eliminate the issue of geographic discrepancy in income since the higher income in the Northeast and West would be weighed against the higher cost of living in those areas.

[13] *Retail Brokerage Account Application*, FINRA, https://www.finra.org/sites/default/files/Industry/p117270.pdf (last visited Mar. 10, 2020).

Some Commenters have suggested to abrogate the definition all together and instead allow all individuals to invest in private placements subject to certain investment limits akin to those in the Crowdfunding Exemption of Title III to the Jumpstart Our Business Startups Act ("JOBS Act"). Regulation Crowdfunding was designed as an accommodation for the internet and is flawed when applied to the accredited investor definition for several reasons. Investment limits cannot serve as an indicator of an individual's sophistication and the limits would, therefore, not identify individuals who do not need the protections of the Securities Act. There is, thus, no statutory authority for adopting such an approach. Furthermore, shifting the focus of the exemption from ensuring that the investor possesses the requisite sophistication to make an informed investment decision, to calculating how much each individual can bear to loose is contrary to the purpose of the Securities Act. This approach would attempt to protect individuals from themselves by limiting the amount of money they may invest but it does in no way protect individuals from fraudulent or risky offerings or enhances their ability to evaluate those risks. Lastly, for the approach to reach its purported goal, it would have to be applied to an individual's total annual investments in the private market, rather than on an investment-by-investment basis. However, this would increase the verification burdens significantly and make it difficult if not impossible for small businesses to comply with the law because the issuers would have to obtain each potential investor's information determining whether they have already reached their investment limit.

IV. CONCLUSION

In light of the foregoing, the author congratulates the Commission for taking up this timely issue of amending the accredited investor definition. To ensure adequate protection of individual investors, the Commission should adjust the current financial threshold for inflation and index it for inflation on a going forward basis. The Commission should refrain from implementing investment limits in the definition as this is contrary to the purpose of investor protection as set out in the Securities Act. Lastly, a category for individuals to qualify as accredited investors based on qualifications other than income and net worth should be added to the current definition.

The author appreciates the opportunity to comment on the Commission's proposed amendments to the accredited investor definition.

Sincerely,

S. Moll

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